

**GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE INSPECTOR GENERAL**

**REPORT ON COMPLIANCE AND
ON INTERNAL CONTROL OVER
FINANCIAL REPORTING
AND
THE DISTRICT OF COLUMBIA
PUBLIC SCHOOLS MANAGEMENT LETTER**



**CHARLES C. MADDOX, ESQ.
INSPECTOR GENERAL**

**OIG No. 02-1-15GA
OIG No. 02-1-16GA**

**August 12, 2002
August 12, 2002**

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Inspector General

Inspector General



August 12, 2002

Dr. Paul L. Vance
Superintendent
District of Columbia Public Schools
825 North Capitol Street, N.E., 9th Floor
Washington, D.C. 20002

Ms. Peggy Cooper Cafritz
President
D.C. Board of Education
825 North Capitol Street, N.E.
Washington, D.C. 20002

Dear Dr. Vance and Ms. Cafritz:

In connection with the audit of the District of Columbia Public School's (DCPS) general purpose financial statements for fiscal year (FY) 2001, KPMG, LLP submitted the enclosed *Report on Compliance and on Internal Control Over Financial Reporting* (Enclosure 1) and the *Management Letter* (Enclosure 2). These documents detail the conditions that DCPS officials should improve in order to enhance the financial management infrastructure of DCPS.

Our analysis of these reports shows that challenges remain for DCPS; therefore, DCPS should take immediate action on the auditor's comments and recommendations to improve the DCPS's internal control structure or affect other operating efficiencies.

We are pleased to receive indications that DCPS is committed to fully resolving each of the findings, weaknesses, and conditions reported. The full text of the DCPS response is included as Enclosure 3.

As with audit findings in general, it is customary to receive from the auditee in their response an identification of specific actions taken or planned and target dates for completion of planned actions. DCPS generally omitted details of its planned actions and target dates. Accordingly, we request that the DCPS readdress the recommendations and provide the OIG details on completed and planned actions and the target dates for completing actions planned. Please provide this information by September 30, 2002.

Dr. Vance and Ms. Cafritz
Transmittal of KPMG LLP Reports
August 12, 2002
Page 2 of 3

If you have questions or need additional information, please contact me or William J. DiVello, Assistant Inspector General for Audits, at (202) 727-2540.

Sincerely,

A handwritten signature in dark ink, appearing to read "Charles C. Maddox". The signature is fluid and cursive, with the first name "Charles" being more prominent and the last name "Maddox" written in a more compact, cursive style.

Charles C. Maddox, Esq.
Inspector General

Enclosures

CCM/ws

cc: See Distribution List

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ENCLOSURE 1



2001 M Street, N.W.
Washington, DC 20036

**Report on Compliance and on Internal Control Over Financial Reporting
Based on an Audit of Financial Statements Performed in Accordance
with *Government Auditing Standards***

To the Members of the Board of Education of the District of Columbia:

We have audited the financial statements of the District of Columbia Public Schools (DCPS) as of and for the year ended September 30, 2001, and have issued our report thereon dated January 22, 2002. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As a part of obtaining reasonable assurance about whether the DCPS' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed the following instances of noncompliance that are required to be reported under *Government Auditing Standards* and are described in greater detail in Appendix A.

- I. Expenditures in Excess of Budgetary Authorization
- II. Non-Compliance with Procurement Regulations

Internal Control Over Financial Reporting

In planning and performing our audit, we considered DCPS internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect DCPS' ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The results of our tests disclosed reportable conditions in the following areas and which are described in greater detail in Appendix B. The status of prior year reportable conditions is presented in Appendix C.

- I. Accounting and financial reporting
- II. Payroll process management
- III. Monitoring of expenditures against open procurements
- IV. Payroll allocation
- V. Fixed assets management



A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider item I to be a material weakness.

This report is intended solely for the information and use of the Board of Education, management, and the District's Office of Inspector General and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

January 22, 2002

MATERIAL NONCOMPLIANCE WITH LAWS AND REGULATIONS

September 30, 2001

I. Expenditures in Excess of Budgetary Authorization

The Anti-Deficiency Act states, in part, the following:

An officer or employee of the United States Government or of the District of Columbia government may not (A) make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation...

The Home Rule Act states, in part, the following:

No amount may be obligated or expended by any officer or employee of the District of Columbia government unless such amount has been approved by Act of Congress, and then only according to such Act.

Section 101 of the DC Appropriations Act 2001, enacted November 22, 2000, states, in part, the following:

Whenever in this Act, an amount is specified within an appropriation for particular purposes or objects of expenditure, such amount, unless otherwise specified, shall be considered as the maximum amount that may be expended for said purpose or object rather than an amount set apart exclusively therefore...

The DCPS' financial statements state in note 1, "The Schools' actual expenditures may not legally exceed budgeted expenditures at the fund level. An unfavorable balance in the budgetary statement for total expenditures in excess of revenues is a violation of the Anti-Deficiency Act." We have confirmed this interpretation with the District's Office of Corporation Counsel.

By allowing expenditures in excess of revenues, DCPS may have violated the Anti-Deficiency and Home Rule Acts.

II. Noncompliance with Procurement Regulations

There were numerous instances of expenditures being incurred by program offices that were not submitted to the budget and finance offices for timely processing. Approximately \$7 million in amounts owed to vendors for goods and services received during 2001 and prior years, but not previously identified for timely payment, were required to be accrued for financial reporting purposes. Approximately \$6.4 million of this amount relates to items that were not presented for ratification for unauthorized purchases of goods and services in accordance with the Office of Contracts and Acquisitions (OCA) Procurement Policy and Procedure Directive No. OCPD 1800. We observed the following instances of noncompliance with established procurement policies during fiscal year 2001.

- Unauthorized personnel placed direct telephone orders with vendors, circumventing DCPS procurement policies;

MATERIAL NONCOMPLIANCE WITH LAWS AND REGULATIONS

September 30, 2001

- Authorized personnel exceeded contract authority; and
- Personnel applied purchases to closed purchase orders (POs) and POs with no funds available.

In addition, POs were processed directly by the CFO's office without following OCA Procurement Policies and Procedures.

**REPORTABLE CONDITIONS IN INTERNAL CONTROL
OVER FINANCIAL REPORTING**

September 30, 2001

I. Accounting and Financial Reporting

The District of Columbia Public Schools (DCPS) expends over \$700 million annually in operating and capital expenditures. These expenditures are reported as a component of the District's public education function in the District's general fund and capital projects fund, respectively. During fiscal year (FY) 2001, we observed the following areas of weakness within the DCPS accounting and financial reporting processes:

- **Monitoring of expenditures** – The detailed break out of original budget approved by Council was not loaded into the accounting system by DCPS personnel timely to allow for appropriate monitoring of expenditures by DCPS management. Further, budget modifications were not loaded into the system timely and there were numerous instances of expenditures being incurred by program offices that were not submitted to the budget and finance offices for timely processing. During the FY 2001 closing process, approximately \$7 million in amounts owed to vendors for goods and services received during 2001 and prior years, but not previously identified for timely payment, were required to be accrued for financial reporting purposes. Further, while performing our testwork on procurement, we noted instances of non-compliance with DCPS procurement policies and procedures. The instances of non-compliance consisted of payments made in excess of purchase orders, direct vouchers were issued to pay vendors, invoices were not cancelled, or dates stamped for receipt of invoices and vendor invoices were not processed timely. Additionally, our test work noted expenditures relating to FY 2000 were partially charged to FY 2001 and DCPS staff could not provide invoices and supporting documentation for 19 disbursements totaling \$6,422,958.
- **Accounting for Medicaid expenditures** – DCPS incurs Medicaid reimbursable expenditures primarily related to services provided to special education students at private schools by third party contractors. However, because the private schools and other vendors do not always provide sufficient or timely encounter data to the DCPS Medicaid program office, many of these costs are considered ineligible for reimbursement by the United States Department of Health and Human Services. At September 30, 2001, a significant adjustment was required to reduce previously recorded Medicaid revenues and receivables that were no longer considered collectible. Further, the Medicaid program office appears to have no established process to follow up with vendors to obtain necessary encounter data to improve DCPS's ability to receive Medicaid reimbursement for special education student services provided. Finally, there is no process in place to provide for timely communication between the Medicaid program office and the DCPS office of financial operations.
- **Capital projects expenditures** – The DCPS capital projects expenditures are processed by purchase orders issued directly by the DCPS CFO's office rather than through the DCPS's procurement office. The procedures for issuing purchase orders are not documented and subsequent invoice processing against the purchase orders do not include the controls for approval that are required for other DCPS procurements. For FY 2001, the majority of the expenditures for capital improvements were provided through service agreements with the Army Corps of Engineers. These agreements define the scope of work to be performed and the source of funding. Various purchase orders are issued against the service agreements; however, there is no process to reconcile goods and services obtained to the provisions of the service agreements. Further, the account coding of expenditures between capital and local funding is not adequately monitored.

REPORTABLE CONDITIONS IN INTERNAL CONTROL OVER FINANCIAL REPORTING

September 30, 2001

- Payroll processing – DCPS failed to appropriately pay approximately 1,700 DCPS employees compensation for pay increases that were due, but not timely processed by the human resources and payroll departments, amounting to approximately \$2.4 million. We also observed numerous instances of employee payroll time sheets, which often provide DCPS's primary basis for obtaining federal reimbursement of eligible payroll costs, that could not be located. Finally, we observed that the payroll reports generated by the CAPPs system are not reconciled timely to the DCPS payroll posted to the general ledger.

Each of these items contributes to the risk that the financial reports relied upon by DCPS management may not be accurate. Accurate and timely management information is essential to DCPS management's ability to identify and respond to significant financial changes (e.g., revenues shortfalls and expenditures in excess of budget). To improve DCPS internal control over financial accounting and reporting, we recommend the following:

- Ensure that DCPS personnel load the annual operating and capital budgets into the accounting system timely and in sufficient detail to allow management to monitor expenditures versus budget more closely. Such information, along with an analysis of significant variances, should be provided to the DCPS School Board on a monthly basis.
- Require Medicaid service providers to provide relevant encounter data to permit DCPS to bill the Medical Assistance Administration (MAA) timely and in sufficient detail to ensure claims for reimbursements are not denied. We understand that requiring such information from the service providers may not be possible under existing contracts. Because the special education program, and the required payments to service providers, are under various court orders, it may be necessary to petition the Court to require service providers to provide such information in a timely manner.
- Monitor contractors hired to administer DCPS capital projects programs more closely. Further, each month DCPS management should review capital expenditures accounts to ensure that there are no significant budget variances and to identify and correct potential improper coding of expenditures between local and capital.
- Monitor the timing of pay increases more closely to ensure that all pay rate changes are processed timely. DCPS management should reemphasize to its timekeepers that adequate maintenance of payroll time sheets is critical to maximizing federal reimbursement under federal grant programs.

We further believe that DCPS has a unique opportunity to evaluate the adequacy of its existing financial accounting and reporting processes due to the anticipated implementation of the PeopleSoft system. We recommend that DCPS conduct a comprehensive review of its payroll, procurement, budget, capital expenditures and Medicaid program accounting and financial reporting processes in conjunction with this system implementation.

II. Payroll Process Management

Over 50% of the DCPS' annual operating expenditures are for employee compensation and benefits. The maintenance of employee personnel information such as personnel action forms and withholding authorizations is a critical component of internal control over the payroll process. Time sheets documenting (1) the hours

REPORTABLE CONDITIONS IN INTERNAL CONTROL OVER FINANCIAL REPORTING

September 30, 2001

worked by employees, (2) related grants or other projects charged, and (3) review and approval must also be maintained. We observed the following:

- Thirty of 60 employee timesheets could not be located or lacked evidence of appropriate management authorization, review and approval of hours worked. We were able to identify other sources of information, such as daily work logs, to substantiate the hours worked.
- Inadequate maintenance of personnel files as evidenced by (1) a number of missing files, (2) files that contained information for more than one employee, (3) incomplete files where appropriate authorization forms were missing, and (4) inadequate physical safeguards over files at storage locations.
- Terminated employees were not always removed from the payroll systems timely.
- Changes to the CAPPS payroll database were not always made timely, and because of CAPPS system limitations, certain employees who were due annual step increases were not awarded those increases when due, requiring retroactive payroll adjustments. These pay adjustments amounted to approximately \$9.9 million during FY 2001, of which approximately \$2.4 million was payable at September 30, 2001.
- SOAR payroll reports were not reconciled to CAPPS.

To improve internal control over the payroll process, we recommend that DCPS:

- Train timekeepers on better methods of ensuring proper documentation is on file for all timesheets, annual leave, and sick leave forms.
- Establish a methodology for employee file maintenance and related physical safeguards and assign responsibility for these matters to a single employee.
- Develop a standard checklist to ensure that all personnel files contain appropriate supporting documentation. Consider a periodic unannounced review of existing files to determine the completeness and accuracy of file data.
- Reinforce established procedures for employee terminations to ensure that they are processed timely.
- Reconcile SOAR payroll reports to CAPPS payroll reports each pay period.

III. Monitoring of Expenditures Against Open Procurements

DCPS finance personnel must approve each contract award to indicate that there is available budget for the goods or services being procured. Based upon this approval, the procurement staff finalizes the contract documents. It is the responsibility of the DCPS finance personnel to properly, and timely, encumber the funds. However, we observed that such encumbrances are not always recorded timely.

**REPORTABLE CONDITIONS IN INTERNAL CONTROL
OVER FINANCIAL REPORTING**

September 30, 2001

Encumbrance monitoring is further complicated by the fact that there is no linkage between the contract files and SOAR. SOAR, through ADPICS, is a purchase order number driven system. In order to process vendor invoices, ADPICS assigns a purchase order number; however, this number bears no relationship to the contract number. Because there is not a one-for-one relationship between the actual contract and the purchase order recognized by SOAR, and because encumbrance information is not readily available, it is possible for payments against purchase orders to exceed the contract value.

While the finance officer should continue to authorize the available funds, we recommend that policies be established to assign the contracting officer the responsibility for recording the encumbrance prior to finalizing the contract. This would ensure that the encumbered funds are in agreement with the final contract value and provide a stronger segregation of duties since the contracting officer has no role in approving or paying invoices. Further, we recommend DCPS develop a monitoring and reporting mechanism that will relate the contracts to the purchase orders and help ensure that payments in excess of contract values are not made.

IV. Payroll Allocation

Certain categories of employees within DCPS are chargeable to DC appropriated funds as well as federal and private grants. Presently, the District's payroll system (CAPPS) does not allocate employees' payroll to more than one fund at the time each payroll is processed. In order to allocate payroll and related personnel costs to the related federal and private grants, the following procedures are currently being performed:

- The affected schools submit to DCPS payroll manually prepared summaries approved by the principals that indicate the names of the employees and the amounts to be charged to each federal and private grant.
- The manually prepared spreadsheets are reviewed for accuracy and completeness by the payroll department.
- Two accounting technicians within the Finance Department then enter the total distribution from each of the manually prepared spreadsheets into a summary Excel spreadsheet containing all schools and/or programs.
- The summarized spreadsheet is then used as a basis for preparing a reclassifying journal entry to allocate the payroll to the respective federal and private grants.

**REPORTABLE CONDITIONS IN INTERNAL CONTROL
OVER FINANCIAL REPORTING**

September 30, 2001

The payroll allocations are not done timely. As a result, draw-downs of federal funds related to expenditures for personnel costs were not performed in a timely manner.

We recommend the following:

- The implementation of PeopleSoft should include the ability to allocate employee's payroll to multiple cost centers.
- DCPS should consider implementing a policy that requires the principals to electronically submit the detailed schedules, on computer generated spreadsheets, to the payroll department each pay period. The spreadsheets should be forwarded to the Finance Department where they can be linked, electronically, to the summary spreadsheet thereby facilitating an easy calculation of the payroll allocation.

V. Fixed Assets Management

In 1999, Valuation Resource Management (VRM) appraised fixed assets held by DCPS. VRM performed a 100% fixed asset inventory count. At that time, all property (both idle property and property in use) was identified, valued and classified in the financial statements. During August 2001, VRM/Maximus performed another physical inventory count; however, this inventory was performed without using FY99 fixed assets valuation as its starting point. Therefore, the Office of Financial Information Systems (OFIS) decided to test-check the inventory count performed by VRM, and found several discrepancies in the count.

As a result, OFIS advised DCPS to reconcile the physical inventory count to their fixed assets reports and notify OFIS of any discrepancies prior to the General Fixed Assets adjustment in ADPICS (the fixed assets module of the general ledger system).

DCPS did not reconcile the fixed assets balance in the general ledger at September 30, 2001 to the physical inventory count.

Further, DCPS follows the District's capitalization policy. Per the District's capitalization policy, current year purchases of items valued in excess of \$5,000 per single physical asset, with a useful life of three years or more, should be capitalized and added to the General Fixed Assets Account Group. We observed some items that were capitalized that were below the \$5,000 threshold for capitalization and an instance where an item should have been capitalized as a fixed asset but was not.

Fixed assets represent a significant portion of DCPS' assets. Therefore, a fixed asset management system is critical to the DCPS' operations. DCPS needs to improve its current fixed assets management procedures. DCPS should reconcile the fixed asset balance in the general ledger to the physical inventory count. In addition, DCPS should record its fixed assets in accordance with its capitalization policy.

**STATUS OF PRIOR YEAR MATERIAL NONCOMPLIANCE
AND REPORTABLE CONDITIONS**

<u>Nature of Comment</u>	<u>Type of Comment</u>	<u>Current Year Status</u>
Missing employee files	Material Noncompliance	Repeated as a reportable condition in item III.
Failure to obtain timely Single Audits	Material Noncompliance	Resolved. Comment not repeated.
Inadequate processing of invoices	Material Weakness	Repeated as a material weakness in item II.
Budget tracking	Material Weakness	Repeated as a material weakness in item I.
Physical inventory not performed	Material Weakness	Inventory was performed but not reconciled. See VI.
Capital leases not properly recorded	Reportable Condition	Comment included in management letter.
Inadequate internal audit	Reportable Condition	Comment included in management letter.
Monitoring of expenditures	Reportable Condition	Repeated as a material weakness in item I.
Payroll allocation	Reportable Condition	Repeated as a reportable condition (item V).
Restricted funds used for other purposes	Reportable Condition	Comment included in management letter as "Appropriated Funds Used for Unauthorized Grant Expenditures".
Emergency payroll procedures were circumvented	Reportable Condition	Resolved. Comment not repeated.